**COLGATE-PALMOLIVE MARKETING SDN BHD** A

**v.**

**KETUA PENGARAH KASTAM**

HIGH COURT MALAYA, KUALA LUMPUR B
MOHD ZAWAWI SALLEH J
[ORIGINATING MOTION NO: R2-25-259-2008]
10 MAY 2011

***CUSTOMS AND EXCISE:*** *Importing - Imported goods - Payment in custom duties and sales tax on goods imported - Whether amount of royalty should be added to purchase transaction value of goods - Customs (Rules of Valuation) Regulations 1999, reg. 5(1)(a)(iv)* C

The respondent had required the applicant to pay RM756,742.28 in customs duties and sales tax on goods imported by the applicant into D Malaysia, contending that the amount of royalty the applicant paid to the licence-holder, Colgate-Palmolive Co USA, should be added to the purchase transaction value of the goods. The respondent decided that the conditions in reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 were satisfied to allow the transaction value of the E goods to be adjusted by adding the royalties paid in respect of the goods. The Customs Appeals Tribunal ('the Tribunal') upheld the respondent's decision. The Tribunal ruled that since royalty had to be paid when the goods were sold, and the whole purpose of the applicant buying the goods was to sell them, it followed that the royalty payments F were a 'condition for the sale of the goods for export to Malaysia'. In its instant appeal to set aside the Tribunal's decision and seek the refund of the sum paid, the applicant contended, *inter alia*, that the royalty payment was not a condition of sale of the goods for export to Malaysia. The applicant said the royalty was paid merely for the right to sell the goods and did not affect the purchase price of the goods. G

**Held (allowing appeal with costs):**

**(1)** The respondent's contention that the payment of the royalty was a condition of the sale of the goods for export to Malaysia did not H hold water. The licence agreement did not make any condition in relation to the purchase of the products by the applicant. The applicant had the option to determine how it intended to source for its products. The royalty and the purchase price of the goods purchased by the applicant were separate and independent transactions. (paras 15 & 16) I

**Case(s) referred to:**

*Mc Guckian v. IRC [1997] 1 WLR 991* ***(refd)***

*National Land Finance Co-operative Society Ltd v. Director General of Inland Revenue [1993] 4 CLJ 339 SC* ***(refd)***

*Nike Sales Malaysia Sdn Bhd v. Jabatan Kastam Diraja Malaysia & Ors [2011] 6 CLJ 352 HC* ***(refd)***

*Palm Oil Research and Development Board Malaysia & Anor v. Premium Vegetable Oils Sdn Bhd [2004] 2 CLJ 265 FC* ***(refd)***

*Stenhouse Holdings v. IRC [1972] AC 661* ***(refd)***

**Legislation referred to:**

Customs Act 1967, ss. 141W, 142(35B)

Customs (Rules of Valuation) Regulations 1999, regs. 4(1)(a), (d), 5(1)(a)(iv)

Interpretation Act 1948 & 1967, s. 17A

Sales Tax Act 1972, s. 68(2), (3)

*For the applicant - K Maniam; M/s Skrine*

*For the respondent - Gan Peng Kun; SFC*

*Reported by Ashok Kumar*

## JUDGMENT

**Mohd Zawawi Salleh J:**

### Introduction

**[1]** The applicant is seeking for the following orders:

(a) that this application be deemed to be a notice of appeal against the decision of the customs appeals tribunal under s. 141W of the Customs Act 1967 and s. 68(2) and (3) of the Sales Tax Act 1972;

(b) that the decision of the customs appeals tribunal made on the 7 August 2008 for the payment of RM756,742.28 being customs duties and sales tax payable on the goods imported by the applicant into Malaysia be set aside;

(c) that the applicant, having padi customs duties and sales tax of RM756,742.28, be refunded the said sum;

(d) such further or other relief as this Honourable Court deems fit; and

(e) costs of and incidental to this application be paid by the respondent.

**[2]** After considering the rival submissions, the court allowed this application with costs fixed at RM8,000 for the applicant.

**[3]** The whole case was a result of the post importation inspection conducted by the Post Importation Branch, Technical Services Division of the Royal Malaysian Customs, Federal Territory, Kuala Lumpur ("Customs WP") back in 2000/2001. Customs WP had interpreted that the transaction value had fulfilled the conditions in reg. 4(1)(a) to 4(1)(d) of the Customs (Rules of Valuation) Regulations 1999 ("the Regulations"). Therefore, Customs WP contended that the royalty paid by the applicant to Colgate-Palmolive Co USA should be added back to the transaction value and to be treated as part of the valuation for the purpose of assessment of sales tax and customs duties.

**[4]** The issue in determining whether the royalty payment is taxable was referred to the Valuation Branch, Technical Services Division of the Royal Malaysian Customs Headquarters ("the respondent"). The customs headquarters decided that the royalties paid by the applicant to Colgate-Palmolive Co USA was an adjustment element that had to be added to the transaction value ie, the price paid or payable because it fulfilled the conditions of reg. 5(1)(a)(iv).

**[5]** In disagreeing with the respondent's view, the applicant submitted that the royalty adjustment shall only be made if and only if it fulfils all the conditions for adjustment as stipulated in reg. 5(1)(a)(iv) which are:

(a) that the royalty payment has been included in the purchase price of the goods;

(b) that the royalty payment is related to the goods that is being imported; paid either directly or indirectly; and

(c) that the royalty payment is a condition of sale of the goods for export to Malaysia.

**[6]** The main issue in contention is whether the condition on the payment of royalty made by the applicant to the licence holder Colgate-Palmolive Co USA would constitute a condition of sale of goods for export to Malaysia. The applicant submitted that it should not because:

(i) the relationship pattern between the applicant and most suppliers reflect the normal practice adopted by the general business community even though they are members of the same group. Such relationship does not influence the sales or purchase price and the applicant is free to buy goods from any supplier according to its needs and determination.

(ii) Royalty paid by the applicant to Colgate-Palmolive Co USA is for the right to sell in the territory they represent. There is no requirement for the royalty to be added back to the transaction value because it is not a condition of sales for export to Malaysia.

(iii) the sales for export to Malaysia by the suppliers of the goods under the Colgate brand have been made without the imposition of any condition by the suppliers or Colgate-Palmolive Co USA that the applicant has to pay royalty to Colgate-Palmolive Co USA. This was proven when the importation of goods were still allowed even though the royalty was not paid and will only be paid after the goods have been sold.

**[7]** The respondent gave a detailed explanation of the law that was applied in reaching the decision that it had made. In its well written grounds of decision, the learned chairman of the tribunal had this to say:

> In arriving at the decision that the royalty payments payable were as a condition of the sale for export, the court gave due regard to the commercial reality or substance of the arrangement between the buyer and the licensor. It also considered the expert opinions of the TCCV (ie, the advisory opinions of the Technical Committee on Customs Valuation) which the court in the *Mattel* case (see *Canada (Deputy Minister of National Revenue) v. Mattel Canada* [2001] 2 SCCR 100, 2001 SCC36 ("the *Mattel* Case") failed to do.
>
> Coming back to the present case, there is no dispute that what is imported here are licensed products as defined in the Royalty Agreement (ie, they bear the trademark, patent or design of which Colgate US is the owner or beneficial owner).
>
> Hence the royalties paid were in respect of the goods imported. The obligation to pay royalty is clearly spelt out in clause 8(a) of the Royalty Agreement, which is as follows:
>
> > 8. In consideration of the rights hereby granted to USER, USER shall:
> >
> > (a) pay to Colgate (U.S) as Royalty Five Percent (5%) of the difference between the USER's Sales to the trade and purchases of Licensed Products.
>
> The rights granted to CP Marketing is the right to use COLGATE (U.S) trademarks, patents and designs. This right "to use" is defined in clause 18 as "the right to sell" within Malaysia the Licenced Products.
>
> Reading the Royalty Agreement as a whole, it is quite clear that CP Marketing could not import the product without incurring a liability to pay royalty on that product when it was sold. Although there is no impediment where purchase of the goods is concerned should CO Marketing default in making royalty payments as submitted by the appellant, in view of the fact that the underlying purpose of purchasing the product is to sell it, as expressed so succinctly in Adidas (see *Adidas New Zealand LTD v. Collection Customs (Northern Region)* [1999] NZAR 39) the ability of CO Marketing to purchase the goods is of no benefit

to it unless it is able to market and sell the product. That is the economic reality and that is why it can be reasonably concluded that the royalty payments were 'as a condition of the sale for export to Malaysia'.

Therefore, on the balance of probabilities I found that the royalties paid by CP Marketing to Colgate US were paid as a condition of the sale for export to Malaysia. The decision of the Director General of Customs is accordingly affirmed.

## The Legal Position

**[8]** On bare reading of s. 142(35B) of the Customs Act 1967 ('Act 235'), it clearly allows the Minister of Finance to make regulations to determine the customs value of imported goods. Section 142(35B) reads:

Section 142: Power to make regulations.

The Minister may make regulations;

(35B) to determine the customs value of imported goods;

**[9]** The regulations pertaining to the rules of valuation are detailed in the Customs (Rules of Valuation) Regulations 1999. In reg. 4(1) Customs (Rules of Valuation) Regulations 1999, the customs value of imported goods shall be their transaction value. Transaction value is the price paid for the goods when sold for export to Malaysia. The relevant parts of reg. 4 reads:

Regulation 4: Transaction value as primary basis of valuation.

(1) The customs value of imported goods shall be their transaction value, that is, the price paid or payable for the goods when sold for export to Malaysia, adjusted in accordance with reg. 5, provided that:

(a) there are no restrictions in respect of the disposition or use of the goods by the buyer, other than restrictions that:

(i) are imposed by law;

(ii) limit the geographical area in which the goods may be resold; or

(iii) do not substantially affect the value of the goods;

(b) the sale of the goods or the price paid or payable for the goods is not subject to some condition or consideration where its value cannot be determined;

(c) no part of the proceeds of any subsequent resale, disposal or use of the goods by the buyer is to accrue, directly or indirectly, to the seller; or

A (d) the buyer and seller of the goods are not related at the time the goods are sold for export or where the buyer and seller are related at that time but the proper officer of customs is satisfied that their relationship did not influence the price paid or payable for the goods.

B …

(3) In any case where the proper officer of customs is of the opinion that the relationship between the buyer and seller of any goods influenced the price paid or payable for the goods, the proper officer of customs shall inform the buyer, in writing if so C requested, of the grounds on which the proper officer of customs formed that opinion, and shall give the buyer a reasonable opportunity to satisfy the proper officer of customs that the relationship did not influence the price.

**[10]** Regulation 5(1)(a)(iv) on the other hand, allows the transaction D value to be adjusted by adding the royalties paid in respect of the goods, *inter alia*, if it forms a condition that the sale of the foods are for export to Malaysia. The relevant portion of reg. 5 reads:

Regulation 5: Adjustment of price paid or payable.

E (1) In determining the transaction value of imported goods under regulation 4, the price paid or payable for the goods shall be adjusted:

(a) by adding thereto amounts, where such amount is not already included in the price paid or payable for the goods, F determined on the basis of sufficient information, equal to:

(i) …

(ii) …

G (iii) …

(iv) royalties and license fees, including payments for patents, trademarks and copyrights in respect of the goods that the buyer must pay, directly or indirectly, as a condition of the sale of the goods for export to Malaysia, exclusive of charges for the rights to reproduce the goods in Malaysia; H …

## The Principles In Interpreting A Taxing Statute

**[11]** Firstly, it is necessary to lay down the approach that this court takes in dealing with the interpretation of a provision of an Act. Gunn I Chit Tuan, CJ (Malaya) in *National Land Finance Co-operative Society Ltd*

*v. Director General of Inland Revenue* [1993] 4 CLJ 339, a Supreme Court decision, laid down the three principles in construing the interpretation of taxing statutes. He said:

> Firstly, there is no room for intendment in tax legislation and the rule of strict construction applies. Unless there are clear words tax cannot be imposed. (per Rowlatt J. in *Cape Brandy Syndicate v. I.R.C.* 12 T.C. 358). Another principle is that where the meaning of a statute is in doubt the ambiguity must be construed in favour of the subject. Yet another principle is that an exemption from tax cannot be removed except by sufficiently clear words to achieve that purpose.

**[12]** There is a noticeable trend towards purposive approach in interpreting a taxing statute (see *Mc Guckian v. IRC* [1997] 1 WLR 991 and *Stenhouse Holdings v. IRC* [1972] AC 661). The purposive approach has long been recognised by Malaysian Law as part of the rule in interpreting legislation. Section 17A of the Interpretation Act 1948 ("Act 388") provides:

> **Section 17A: Regard to be had to the purpose of Act**
>
> In the interpretation of a provision of an Act, a construction that would promote the purpose or object underlying the Act (whether that purpose or object is expressly stated in the Act or not) shall be preferred to a construction that would not promote that purpose or object.

**[13]** In *Palm Oil Research and Development Board Malaysia & Anor v. Premium Vegetable Oils Sdn Bhd* [2004] 2 CLJ 265 Gopal Sri Ram, JCA (as he then was) had this to say about interpreting a taxing statute:

> In my judgment s. 17A has no impact upon the well established guidelines applied by courts from time immemorial when interpreting a taxing statute. Section 17A and these guidelines co-exist harmoniously for they operate in entirely different spheres when aiding a court in the exercise of its interpretive jurisdiction. The correct approach to be adopted by a court when interpreting a taxing statute is that set out in the advice of the Privy Council delivered by Lord Donovan in *Mangin v. Inland Revenue Commissioner* [1971] AC 739:
>
> > First, the words are to be given their ordinary meaning. They are not to be given some other meaning simply because their object is to frustrate legitimate tax avoidance devices. As Turner J said in his (*albeit* dissenting) judgment in *Marx v. Inland Revenue Commissioner* [1970] NZLR 182 at 208, moral precepts are not applicable to the interpretation of revenue statutes.
> >
> > Secondly, '... one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption so to a tax. Nothing is to be

A read in, nothing is to be implied. One can only look fairly at the language used.' (Per Rowlatt J in *Cape Brandy Syndicate v. Inland Revenue Commissioners* [1921] 1 KB 64 at 71, approved by Viscount Simons LC in *Canadian Eagle Oil Co Ltd v. Regeim* [1945] 2 All ER 499, [1946] AC 119.

B Thirdly, the object of the construction of a statute being to ascertain the will of the legislature, it may be presumed that neither injustice nor absurdity was intended. If therefore a literal interpretation would produce such a result, and the language admits of an interpretation which would avoid it, then such an interpretation may be adopted.

C Fourthly, the history of an enactment and the reasons which led to its being passed may be used as an aid to its construction.

In my respectful view, *s. 17A of the Interpretation Acts 1948 and 1967* neatly fits into and is complementary with the third principle in the D judgment of Lord Donovan. *Hence, the governing principle is this. When construing a taxing or other statute, the sole function of the court is to discover the true intention of Parliament. In that process, the court is under a duty to adopt an approach that produces neither injustice nor absurdity: in other words, an approach that promotes the purpose or object underlying the particular statute albeit that such purpose or object is not expressly set out therein.* E (emphasis added)

**The Court's Findings**

**[14]** The issue before the court is whether the respondent should charge additional royalty to the transaction value of imported goods in F accordance to reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

**[15]** With respect, the respondent's contention that the royalty was a condition of the sale of the goods for export to Malaysia because royalty G was paid to Colgate-Palmolive Co USA by the applicant does not hold water. The licence agreement does not contain any provision requiring the applicant to source for the products from any related parties. It does not make any reference or condition in relation to purchase of the products by the applicant. The applicant holds the option to determine how it intended to source its products. The decision to choose the H source was a pure commercial reasons such as to achieve better costing through economics of scale, price, commercial friendliness, quality and consistent quality of the products.

**[16]** To my mind, what seems to be clear is that the royalty and the I purchase price of the products purchased by the applicant are separate and independent transactions.

**[17]** The most recent case which had similar bearings to this case is the unreported decision of my learned brother YA Tuan Mohamad Ariff Md Yusof in *Nike Sales Malaysia Sdn Bhd v. Jabatan Kastam Diraja Malaysia & Ors* [2011] 6 CLJ 352. In this case, Nike Sales Malaysia ("Nike") filed a judicial review against the decision of the Jabatan Kastam Diraja Malaysia (which is also the respondent in this case) against the demand by the respondent for the payment of RM3,292,076.91 as customs duties and sales tax payable by Nike Malaysia under the same regulation ie, reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999.

**[18]** In that case, the learned judge had taken the task and had gone in intrinsic detail in explaining the jurisprudence underlying the reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999 with reference to authorities in Malaysia, Canada, Australia and New Zealand just to name a few. He even cited the advisory opinions of the technical committee on customs valuation established under the WTO valuation agreement called the agreement on implementation of art. VII of the general agreement on tariffs and trade 1994, of which Malaysia is a signatory.

**[19]** The court in that case allowed the appeal and concluded that if the Parliament had intended that royalty paid in relation to an export of goods be regarded as an adjustment item for the purposes of calculating customs value, there will be no need to further provide for the conditions in reg. 5(1)(a)(iv) of the Customs (Rules of Valuation) Regulations 1999. Be that as it may, the court in that case was minded that it was indeed necessary to consider both economic reality and the legal relationship underlying the business transaction flow on the facts of that case.

**[20]** The court finds no reason to differ from the above decision. The court is persuaded that His Lordship's decision is correct.

**[21]** The respondent tried to distinguish the case with the facts of the present case stating that the conclusion arrived in that case is peculiar to its own facts. This court however disagrees and is of the considered view that the *Nike Sales Malaysia Sdn Bhd v. Jabatan Kastam Diraja Malaysia & Ors* is indeed a relevant case to be referred to as the issues before it are more or less similar to the issues in this case.

**[22]** Finding much support from the *Nike Sales Malaysia Sdn Bhd v. Jabatan Kastam Diraja Malaysia & Ors* case and for the reasons above stated, the court is of the opinion that this appeal ought to be allowed with costs.